KROES ENERGY INC.

1998 ANNUAL REPORT

CORPORATE PROFILE

Kroes Energy Inc. is a junior oil and gas exploration and production company headquartered in Calgary, Alberta, Canada and listed on the Alberta Stock Exchange. It is the objective of the Company to participate in oil and gas ventures both in Canada and outside of Canada.

The Company presently has interests in crude oil and associated gas production in western Saskatchewan; a carried interest in three exploration blocks off the south coast of Cuba; and is farming into a 1,900 acre block on the Cedros peninsula of southern Trinidad which now produces a small volume of oil.

DIRECTORS

Stephan V. Benediktson
Cochrane, Alberta

Fred Callaway
Calgary, Alberta

N. (Bill) Khouri
Calgary, Alberta

David E. Powell
Calgary, Alberta

Richard A. Wilson
Calgary, Alberta

OFFICERS

Fred Callaway
President

Richard A. Wilson
Secretary

ANNUAL MEETING

The Annual Meeting of the Shareholders will be held in Calgary on Tuesday, June 8, 1999 at 3:00 pm in the Cardium room of the Calgary Petroleum Club, 319 - 5 Ave. SW.

KROES ENERGY INC.

1998 ANNUAL REPORT

To the Shareholders

1998 was a difficult year for junior oil and gas companies and Kroes Energy Inc. was no exception. The impact of low crude oil prices and the lack of interest by investors were major obstacles but, as 1999 gets underway, there is some hope that better times are on the way.

Financial and operating results

The Company's interest in the Eureka field in Saskatchewan was sold effective January 1,1998 for $125,000 and as a result, production for 1998 was 18 barrels per day lower than in 1997. Production for 1998 from the remaining Druid and Whiteside properties averaged 53 barrels of oil equivalent per day, unchanged from 1997. These properties produced net revenue of $369,366 and after operating expenses, property taxes and lease rentals, generated net operating income of $38,161, down by $116,000 from 1997 due to lower prices and the lower level of production. The average crude oil price received in 1998 was $19.60 per barrel compared to the $27.11 average for 1997, a decline of $7.90 per barrel.

The low oil price at year-end caused the Company to experience a ceilings test write-down of $256,516 under unrealistic but required accounting policies. This reduces the cost base of our Saskatchewan producing properties to zero. If the same ceilings test was carried out using the April 30, 1999 price of approximately $25.00 per barrel, the value would be $360,000 and no write down would be necessary. Unfortunately, the accounting policies do not allow a reinstatement of costs when prices recover. Not only are the 1998 financial statements negatively distorted by these policies, but future year's financial results will be overstated because there will be no charge against income for depletion, depreciation and amortization of our Canadian properties.

The ceilings test write-down combined with other non-cash charges and a cash deficit from operating and administrative activities, resulted in a net loss of $367,929 for the year.

Rights offering

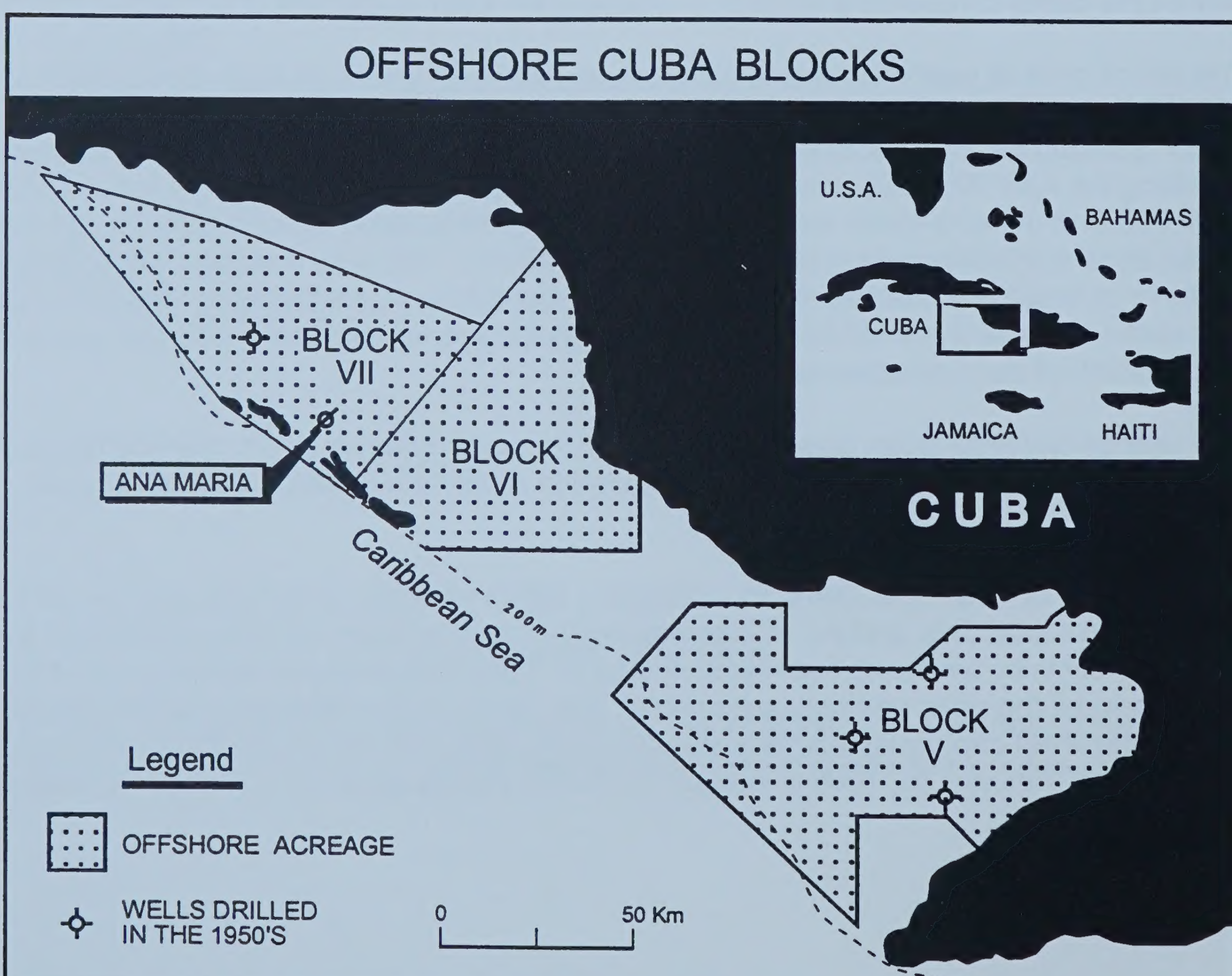
In December of 1997, the Company initiated a rights offering. One right was issued for each share outstanding, and the holder was entitled to purchase one new common share for twenty cents by tendering two rights. A total of 3,565,286 common shares would have been issued if the offer was fully subscribed. The timing of this offering was unfortunate, as both the small cap equity markets and oil prices were depressed. On the expiration of the rights on January 26, 1998 a total of 1,518,870 shares were issued for net proceeds of $280,009.

Cuba

Kroes Energy holds a 4.875% carried interest in exploration blocks V, VI and VII off the south west coast of Cuba. Under this interest, Kroes will receive 4.875% of the revenue from production after deducting operating and capital cost recovery and government share. Some 3,700 kilometers of seismic surveys have been carried out on the blocks and interpretation of the data has identified approximately 10 prospects and leads, a number of which have sufficient coverage to justify drilling.

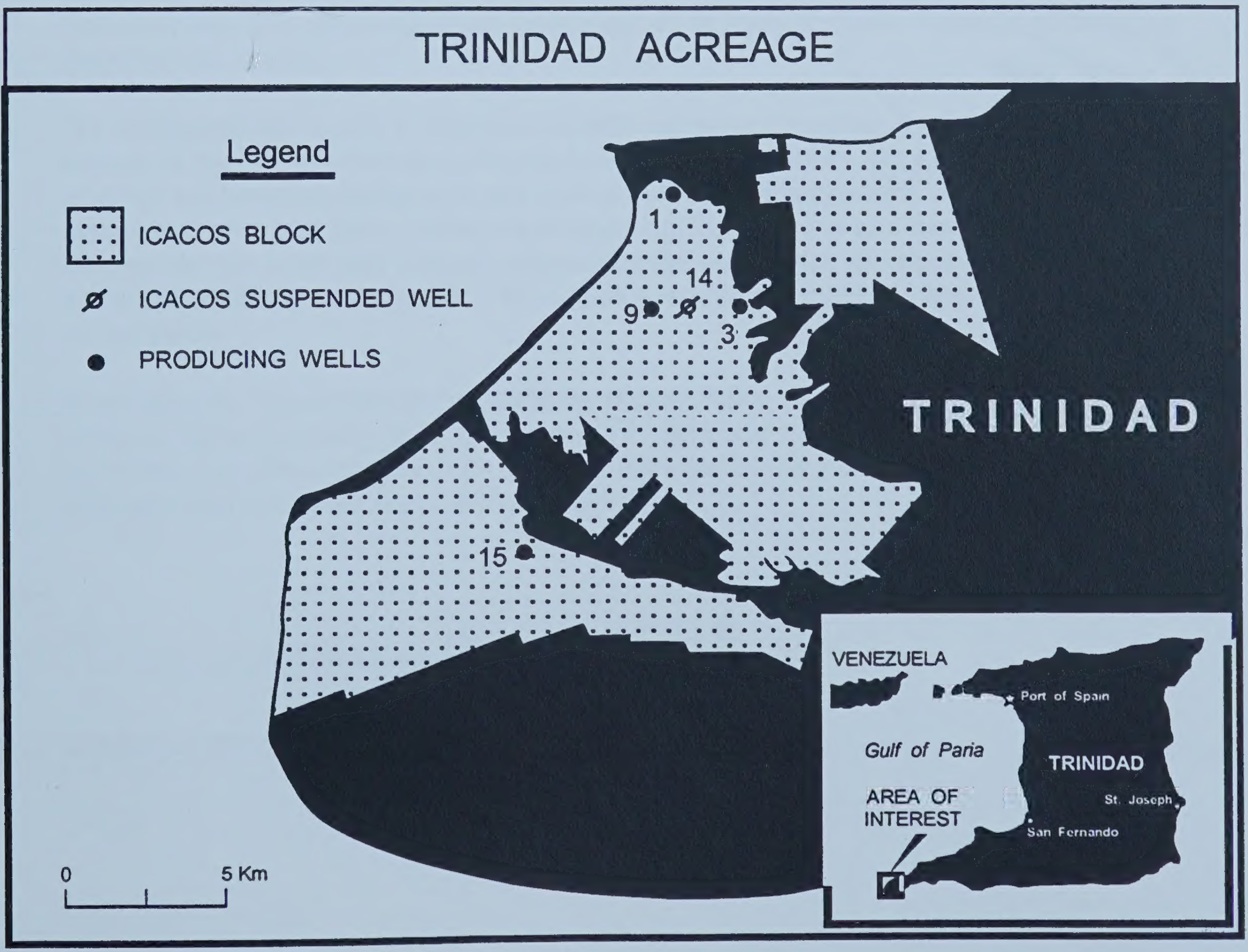
The Ana Maria #1 well was drilled on Block VII in July of 1997 and encountered oil and gas shows but was located on the flank of this very large structure and did not produce hydrocarbons during testing. The Ana Maria #2 well was deviated to the crest of the structure from the same surface location and reached total depth in December of 1998. It encountered gas shows but the prospective formation was tight. The Operator then spudded Ana Maria #3 and deviated to a point between the two previous bottom hole locations. This well was completed in January 1999 but unfortunately, found that significant hydrocarbons were not present in the structure.

The Operator is presently assessing the technical results of the drilling to date and awaiting the results of drilling by other operators on adjoining lands. A dredged island location has been prepared on a large structure in the vicinity of Ana Maria but the location of the next well will not be selected until late in 1999 and drilling will probably begin early in the year 2,000.



Trinidad farm-in
In November, 1997 Kroes entered into an agreement with Eastern Petroleum Australia P/L to participate in Eastern's farmin on the 1,900 acre Icacos Block on the Cedros Peninsula of Trinidad. Kroes and Eastern each must pay 50% of the cost to drill two earning wells and each will earn a 25% working interest in the block, including the existing production which now totals about 45 barrels per day. The agreement also provides for the partners to recover their drilling costs from production from the earning wells before the farmor receives a share of the proceeds.

There are a total of 13 wells previously drilled on the block and there is potential to re-enter some of them to enhance or initiate production. The first earning well, Icacos #14, began drilling in December, 1997 and was suspended early in January, 1998 after encountering water and low oil saturation in an upthrown fault block. Kroes 50% share of the cost of this well was approximately $250,000. A review of technical data from existing wells was completed 1998, and it was decided that, while a seismic program could reduce the dry hole risk, there is considerable doubt with respect to the quality of seismic records in this area. In addition, the economics of drilling the final earning well immediately and obtaining the working interest in current production led the partners to the decision to drill Icacos #15.



The #15 well will be located on the southern portion of the Block where three wells were drilled in the 1920's. One of the wells produced a small amount of 40 degree crude oil before being abandoned after the drilling tools were lost in the hole. In the new well, the sands are expected to be encountered between 900 and 1,400 feet but the program calls for drilling to a total depth of 2,500 feet to gain more information on the geology of the area. Drilling should be complete by the middle of May and Kroes' estimated share of the total cost is $125,000.

The Davy Prospect
In February of 1998, Kroes agreed to take a 10% interest in a farm-in to an exploratory Leduc oil play (the Davy Prospect) located on a 1,280 acre block in central Alberta. The Company and its partners undertook to complete a 3-D seismic program and drill a well to 8,500 feet to test the prospect. The seismic program was completed but following interpretation, the prospect was deemed too small to warrant drilling. As a result, the acreage has been dropped. The total cost to Kroes Energy was $29,000.

Plans for 1999
With the improvement in oil prices early in 1999, we are hopeful that existing production will provide sufficient cash flow to investigate a number of new projects that have come to our attention. In the meantime, Kroes Energy is seeking the modest financing required to complete the drilling of the last earning well in Trinidad.

Fred Callaway, President

May 4, 1999

PRICEWATERHOUSECOOPERS

PricewaterhouseCoopers LLP
Chartered Accountants
425 1st Street SW
Suite 1200
Calgary Alberta
Canada T2P 3V7
Telephone +1 (403) 509 7500
Facsimile +1 (403) 781 1825

March 18, 1999

AUDITORS' REPORT

To the Shareholders of
Kroes Energy Inc.

We have audited the balance sheets of **Kroes Energy Inc.** as at December 31, 1998 and 1997 and the statements of operations and deficit and changes in financial position for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 1998 and 1997 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants

KROES ENERGY INC.

BALANCE SHEET

	December 31 1998	1997
Assets		
Current assets		
Cash	$ 47,985	$ 3,884
Accounts receivable	54,681	40,366
Prepaid expenses and deposits	47,888	79,138
Advances	-	2,808
	150,554	126,196
Capital assets *(Note 2)*	937,705	1,294,305
	$ 1,088,259	$ 1,420,501
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	$ 5,081	$ 221,660
Shareholder's loan, unsecured, non-interest bearing	-	40,000
	5,081	261,660
Site restoration	21,470	9,213
Shareholders' Equity		
Share capital *(Note 3)*		
Common Shares issued	1,793,446	1,513,437
Deficit	(731,738)	(363,809)
	1,061,708	1,149,628
	$ 1,088,259	$ 1,420,501

Commitments and contingency (Note 8)

Approved by the Board ______ **Director** ______ **Director**

STATEMENT OF OPERATIONS AND DEFICIT

	Year ended December 31 1998	1997
Revenue		
Production	**$ 369,366**	$ 646,901
Interest and other income	**4,896**	837
	374,262	647,738
Expenses		
General and administrative	**94,390**	94,678
Operating	**331,205**	492,736
Depletion, depreciation and amortization	**47,823**	126,748
Additional depletion *(Note 2)*	**256,516**	262,666
Future site restoration	**12,257**	16,536
	742,191	993,364
Net loss for the year	**(367,929)**	(345,626)
Deficit, beginning of year	**(363,809)**	(18,183)
Deficit, end of year	**$ (731,738)**	$ (363,809)
Net loss per share	**$ (0.04)**	$ (0.06)

KROES ENERGY INC.

STATEMENT OF CHANGES IN FINANCIAL POSITION

	Year ended December 31 1998	1997
Cash (used in) provided by operating activities		
Net loss for the year	**$ (367,929)**	$ (345,626)
Add back non-cash items		
Depreciation, depletion and amortization	**47,823**	126,748
Additional depletion	**256,516**	262,666
Site restoration	**12,257**	16,536
	(51,333)	60,324
Change in non-cash working capital	**(196,836)**	212,264
Actual site restoration costs	**-**	(7,323)
	(248,169)	265,265
Cash provided by (used in) financing activities		
Issue of Common Shares for cash	**280,009**	32,500
Issue of Common Shares for the purchase of Hogar Energy Inc.	**-**	1,021,730
Promissory note	**(40,000)**	(470,000)
	240,009	584,230
Cash (used in) provided by investing activities		
Purchase of Hogar Energy Inc., net of cash $16,522	**-**	(1,025,908)
Hogar Energy Inc. promissory note	**-**	470,000
Acquisition of oil and gas properties	**(75,239)**	(309,253)
Proceeds on disposal of properties	**127,500**	16,598
	52,261	(848,563)
Change in cash for the year	**44,101**	932
Cash at beginning of year	**3,884**	2,952
Cash at end of year	**$ 47,985**	$ 3,884

NOTES TO FINANCIAL STATEMENTS
December 31, 1998

1 Significant accounting policies

a) Full cost method of accounting

The Company follows the full cost method of accounting whereby all costs relating to the exploration for, and the development of, oil and natural gas reserves are capitalized on a country-by-country cost centre basis. Costs accumulated within each cost centre are depleted and depreciated using the unit-of-production method, based on estimated gross proved reserves with production and reserves volumes of natural gas converted to equivalent energy units of crude oil. Proceeds from disposal of properties are normally deducted from the cost centre except when the disposition results in a significant change in the depletion rate in which case a gain or loss on disposal is recognized.

Costs of exploration in new cost centres, together with related land costs, are excluded from costs subject to depletion and the ceiling test until it is determined whether or not proved reserves are attributable to the properties, or if impairment has occurred. Costs capitalized in Cuba and Trinidad are considered by management to be new cost centres.

In determining the depletion and depreciation provisions for oil and natural gas assets, the Company includes any excess of the net book value of those oil and natural gas assets over the unescalated, undiscounted future net operating revenues from its proved oil and natural gas reserves for each cost centre (ceiling test). A second ceiling test calculation is conducted on an enterprise basis, by including in the depletion and depreciation provisions any excess of the net book value of oil and natural gas assets less deferred taxes and the future dismantlement and site restoration costs for all cost centres over the unescalated, undiscounted future net revenues from proved oil and natural gas reserves, plus the cost of undeveloped properties, less future general and administrative expenses, financing costs and income taxes.

b) Future dismantlement and site restoration costs

Estimated future dismantlement and site restoration costs for oil and gas assets are provided using the unit-of-production method.

c) Joint ventures

Substantially all of Kroes's oil and gas exploration, development and production activities are conducted jointly with others. The financial statements reflect only Kroes's proportionate interest in such activities.

d) Foreign currency translation

- Monetary assets and liabilities - at the period-end rate of exchange.
- Other assets and liabilities - at historical rates of exchange.
- Revenues and expenses - at monthly rates of exchange except provisions for depletion and depreciation which are translated on the same basis as the related assets.

Unrealized gains and losses on translation to Canadian dollars of long-term monetary assets and liabilities are deferred and amortized over the remaining lives of the related assets and liabilities.

e) Net income (loss) per share

Net income (loss) per share is calculated using the weighted average number of shares outstanding.

f) Measurement uncertainty

The amounts recorded for depletion and depreciation of property, plant and equipment and the provision for site restoration costs are based on estimates. The ceiling test is based on estimates of proved reserves, production rates, natural gas prices, future costs and other relevant assumptions. The property, plant and equipment costs recorded for operations in Cuba and Trinidad are estimated by management to be fully recoverable, however, there are no proven reserves at December 31, 1998 to perform a ceiling test calculation. By their nature these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future periods could be significant.

2 Capital assets

	1998	1997
Office furniture and equipment	$ 3,874	$ 3,874
Intangible oil and gas properties	1,510,733	1,540,640
Tangible oil and gas equipment	116,851	139,205
	1,631,458	1,683,719
Accumulated depletion and depreciation	(693,753)	(389,414)
	$ 937,705	$ 1,294,305

The ceiling test write-down for Canadian assets was $256,516 (1997- $262,666) which reduced the Canadian Capital assets to zero. The ceiling test for Canada used year end prices. The use of average prices for the year would have also reduced the Canadian assets to zero.

Included in intangible oil and gas properties is the cost associated with Cuban assets of $602,681 which is the amount paid by Kroes to earn the interest presently held. Although a dry hole was drilled on the acreage, the asset is not deemed impaired as a follow-up well will be drilled in 1999 on the earned acreage. In addition, a third party property transaction in 1997 involving this acreage indicates continued commercial value.

Included in intangible oil and gas properties is the cost associated with the Trinidad assets of $332,273. There is continuing operations on this property although Kroes has not yet earned its working interest in existing proven reserves and production. The asset is not deemed impaired at December 31, 1998.

3 Share capital

The Company's authorized share capital is an unlimited number of Common Shares and an unlimited number of Preferred Shares issuable in series. No Preferred Shares have been issued.

Common Shares issued

	Number of shares	Amount
Beginning balance, December 31, 1996	3,575,000	$ 459,207
Amalgamation of Hogar Energy Inc. (net of fees of $20,700)	3,430,471	1,021,730
At $0.20 exercised under agent's options	75,000	15,000
At $0.35 Warrants of Hogar Energy Inc. exchanged for shares in Kroes Energy Inc.	50,000	17,500
Issued and outstanding at December 31, 1997	7,130,471	1,513,437
At $0.20 exercised under rights issued December 23, 1997	1,518,870	303,774
Issuance costs	-	(23,765)
Issued and outstanding at December 31, 1998	8,649,341	$ 1,793,446

Options to purchase 350,000 Common Shares at $0.20 per share were granted to directors and officers of the Company in 1996. The options expire September 24, 2001.

Options to purchase 480,000 Common Shares at $0.20 per share were granted to directors and officers of the Company in 1998. The options expire February 19, 2003.

2,046,416 rights to purchase Common Shares at a price of $0.20 per Common Share expired January 26, 1998.

262,709 Warrants issued to purchase Common Shares at a price of $0.35 expired December 31, 1998.

4 Income taxes

The Company has income tax pools for intangible costs and tangible costs of approximately $1,517,184 and $105,531, respectively, and share issue costs of $73,800 which can be claimed for tax purposes in future years. The Company has a non-capital loss of $39,315 carried forward for which no benefit has been recognized.

5 Geographic segments

The Company is organized into divisions by geographic area consisting of Canada, Cuba and Trinidad. All divisions derive revenue from oil and gas properties or are pursuing oil and gas production from properties.

	December 31, 1998			
	Canada	Cuba	Trinidad	Total
Net revenue	$ 374,262	$ -	$ -	$ 374,262
Loss for the period	(355,200)	-	(12,729)	(367,929)
Identifiable assets	78,458	602,681	407,120	1,088,259

	December 31, 1997			
	Canada	Cuba	Trinidad	Total
Net revenue	$ 647,738	$ -	$ -	$ 647,738
Loss for the period	(345,626)	-	-	(345,626)
Identifiable assets	529,216	602,681	288,604	1,420,501

6 Acquisition

In May of 1997, Kroes Energy Inc. purchased all of the outstanding shares of Hogar Energy Inc. Kroes issued Common Shares on a 1 for 1 basis, for the Class B common voting shares of Hogar Energy Inc.

The acquisition was accounted for as a purchase. The purchase price equation was as follows:

Cash	$ 16,522
Accounts receivable	2,509
	19,031
Promissory note receivable	*470,000
Advances under Participation Agreement	586,143
	1,075,174
Accounts payable	(32,744)
Purchase price prior to acquisition costs	$ 1,042,430

*The promissory note received from the Company was eliminated on amalgamation.

7 Uncertainty due to the Year 2000 Issue

The Year 2000 Issue arises because many computerized systems use two digits rather than four to identify a year. Date-sensitive systems may recognize the year 2000 as 1900 or some other date, resulting in errors when information using year 2000 dates is processed. In addition, similar problems may arise in some systems which use certain dates in 1999 to represent something other than a date. The effects of the Year 2000 Issue may be experienced before, on, or after January 1, 2000, and, if not addressed, the impact on operations and financial reporting may range from minor errors to significant systems failure which could affect an entity's ability to conduct normal business operations. It is not possible to be certain that all aspects of the Year 2000 Issue affecting the entity, including those related to the efforts of customers, or other third parties, will be fully resolved.

8 Commitments and contingency

The Company has commitments related to its Trinidad property. If sufficient funds are not available to meet these commitments, then other agreements will have to be entered into which would likely reduce the Company's interest in these areas.

The Company has estimated future site restoration liabilities of $56,127 which will be accrued over the remaining production life of the Canadian assets.

KROES ENERGY INC.
CORPORATE INFORMATION

Offices

260, 435 - 4 Avenue SW
Calgary, Alberta, Canada
T2P 3A8

Banker

Bank of Nova Scotia
Calgary, Alberta, Canada
San Fernando, Trinidad, West Indies

Auditor

Price Waterhouse
Calgary, Alberta

Solicitor

McCarthy Tetrault
Calgary, Alberta

Transfer Agent

Montreal Trust Company of Canada
Calgary, Alberta

Stock Exchange Listing

Alberta Stock Exchange
Trading Symbol: KRS

Kroes Energy Inc.